BOOK REVIEWS AND NOTICES

Valuation and Rate-Making. By ROBERT L. HALE, PH.D. (No. 185, Vol. LXXX, Columbia University Studies in History, Economics, and Public Law.) New York: Columbia University Press, 1918. Pp. 156.

Three important distinctions play a central part in this study of valuation. One is the distinction between valuation as a record of fact and valuation as an attempt to solve the question of policy or of fairness and decide what value should reasonably be allowed to the owners of public-service properties. A second is the distinction between fair policy with reference to the past, in the light of past uncertainties in court decisions and the absence of an announced program on the part of government, and policy for the future in case some definite theory can be adopted and a program announced. Paralleling this runs the distinction between the incentive theory of control, which might justly be adopted for the future, and the theory of equality of treatment between regulated and unregulated businesses, which plays a large part in considering the question of fairness to the present owners of property invested in the past.

The author finds the rationale underlying many cases of the cost-of-reproduction type of valuation in the attempt to record a fact, namely, the "exchange value of the physical property" as distinct from the property as a whole. The value of the property as a whole, being based on earnings, cannot be used as a standard on which to determine what fair earnings are. The market value of the physical property, on the other hand, is taken to be what the company possessing the rights to operate would pay to an owner not in possession of those rights. This could not be more than the total earnings-value of the property as a going concern, nor more than what it would cost to produce a substitute plant "which, from the point of view of revenue production, would be equally efficient." Not all cases under the cost-of-reproduction theory could be squared with this principle. Indeed the idea of cost of reproduction under original conditions, the author holds, does not belong in spirit with the cost-of-reproduction theory at all, but is rather a method of getting at the original cost of the existing property, as far as that was reasonably and properly incurred.

This latter is the standard which appears to the author best to fit the requirements of the incentive theory of regulation—that theory which aims to furnish sufficient, and no more than sufficient, incentive to get the service which the public requires. He evidently considers that the necessary capital can be most cheaply secured by offering a maximum of stability and a minimum of such speculative stimulus as the cost-of-reproduction theory offers. As to possible differential rewards that might be needed to stimulate efficient management, he holds with Professor Bauer that extra returns to the stockholders are of less avail than personal incentives to the active managers.

As far as past investments are concerned, we are not free to follow this theory but must consider the reasonable expectations, both of the original investors and of subsequent innocent purchasers. As far as the latter are concerned, any earnings that have been allowed have created a self-perpetuating claim to remain undisturbed, and it does not affect the nature of the innocent purchaser's loss whether original cost or reproduction cost be the standard to which the value of his holdings is reduced. Without going so far as to say that no reductions should be made, the author holds that "it may be well to allow more than is constitutionally necessary" in cases where "the stock is widely held by persons of little means, who themselves paid the present price for it, or if it is held extensively as the basis of credit at its present value." Thus the stock-market history of the securities is added to the list of criteria of fair value which has come down to us from the case of *Smyth* v. *Ames*. "When, on the other hand, the stock . . . . is largely in the hands of the original owners and is not held by savings banks or insurance companies and is not the basis of much credit, the initial figure may well be put as low as the Supreme Court will allow."

Perhaps the distinguishing feature of this interesting and discriminating study is the suggestion that the court rulings on valuation are not final, that they were conditioned by the lack of any standard of control announced prior to the investment of the capital whose returns were being called in question, and that if such a policy were announced for the future it might be sustained by the courts even if it does not conform to their own past rulings. The present is a peculiarly opportune time to consider the possibility of a "new deal" and the discarding of precedent in railroad regulation. It is a pity the Supreme Court cannot itself be induced to announce in advance whether it will or will not rule in accordance with Dr. Hale's "reasonable expectations" and protect the "innocent promoters" of a policy of regulation for future investments based on the "incentive theory."

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